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April 14, DJIA 795.13; PTI 759; A-D Ratio –19.38
April 21, DJIA 812.80; PTI 774; A-D Ratio –19.04

"CORRECTION CITY": What's happening? I believe we're in a period where **everything is correcting against its own primary trend.** For instance, against extended preceding trends in the opposite direction, the dollar is now rallying, the stock market is rocketing, gold is declining, the Swiss franc is tumbling, commodities are sliding, interest rates are firming. It happens. Who knows, maybe President Carter may even "correct" and do something or say something that makes sense. But remember, it would only be temporary.

Subscribers may wonder why I didn't send out a special report last week. The answer is that I have learned not to jump half-cocked on the basis of an emotional market. Any special report I sent out could have been wrong before the ink was dry. I prefer either to be very sure of what I'm writing about in a special report, or sit tight until I am reasonably sure–and then write the regular Letter, which is what I'm doing now.

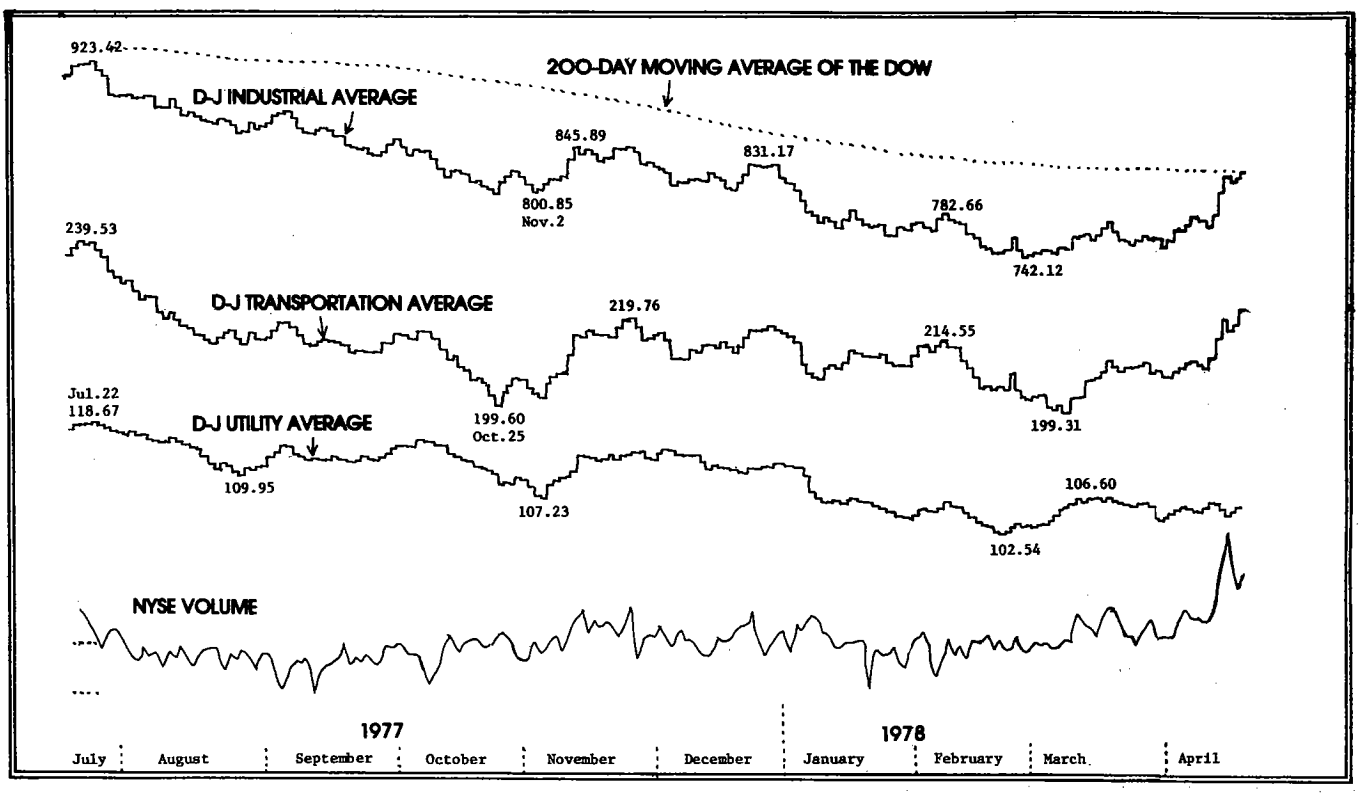
Upward "whooshes" on extraordinary volume are movements that are characteristic of bear market rallies, not advances in primary bull markets. Bull market advances (as I've said many times) tend to be plodding, slow and labored. In fact, many bull market advances are so grinding that (except for the fact that prices are increasing) they appear on the charts as gigantic bores.

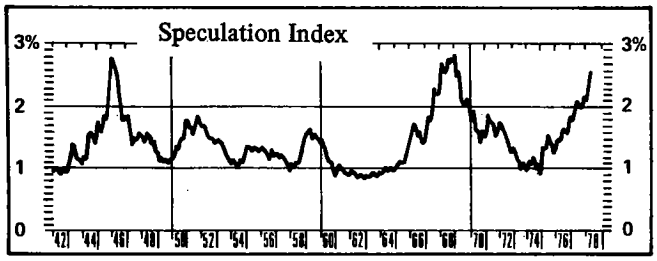
Most of the great buying, the most profitable buying, is usually done in quiet areas and in dull markets. Such listless periods, at least on the surface, appear to be areas when nobody wants stocks or when conditions are so depressing that nobody is even thinking of Wall Street. Of course, this kind of atmosphere is exactly the kind that is conducive to informed accumulation. By that I mean accumulation by investors who can pick up stocks at their leisure and at their price–with little or no competition.

Most of the great selling is done in exciting, high volume areas. These are the explosive periods where "everybody" wants stocks in any quantity at any price. At such times, huge quantities of equities can be shoveled out to excited buyers whose only thought is to "grab 'em before they go higher." Nobody knows exactly why, but there are certain times in the history of Wall Street when everyone is well nigh convinced that equities are heading for the moon.

One of the features of the current market has been the speculation in low-priced stocks. Another, of course, has been the record-breaking NYSE **volume** of last week. I think this little chart (page 2) from Indicator Digest (Palisades Park, NJ 07650) tells a most remarkable story. In Letters over the past year I published my chart of the relative strength of Standard & Poor's Low-Priced Stock Index compared with their High Grade Common Stock Index, but this chart shows it even better. Here we see the ratio of the S&P Low-Priced Index to the High-Priced Index.

The fascinating fact is that we are now seeing only the third speculative peak in this index in 41 years. The first peak came in 1945, just prior to the bear market of 1946-49. The second peak came in 1968, just prior to the speculative cave-in of 1969-70. And now we are moving well into the third speculative peak (if we are not through it). I leave the conclusions to subscribers.





My friend Joe Granville (who has been brilliant about this market) notes in his latest report that there is a new trend sweeping the nation. The new trend is called "gambling." And the impetus behind today's gambling is the phenomenon of seemingly "endless inflation." People, it seems, are thinking as follows: *"They're destroying the currency. They're wiping out my savings and my purchasing power, and they're taxing whatever is left. So why not spend it while I can still get some fun out of it!"* The result isn't Saturday Night Fever, it's gambling fever.

Last week we were treated to the spectacle of the first, second and fourth biggest volume days in NYSE history. We also witnessed an astounding three "gaps" in the Dow over six trading days. To my knowledge, there have never been two consecutive gaps in two days (such as April 14 and 17) much less three gaps in six days. A gap is produced when the pressure is so intense that a given day's low (on the Dow in this case) is above the preceding day's high. The resulting hole in the chart is termed a gap. Such gaps seldom appear in a stock average. But I have no doubt that the three-gap phenomenon of mid-April was produced by a frantic desire on the part of buyers to jump aboard.

My own opinion is that most of the buying was done by funds who are handling "other people's money." The fund managers can take it if their funds go down along with the other funds, but they are terrified if the market (and the other funds) go up without them. Thus, the herd instinct took over in mid-April as over 200 million shares tried to squeeze into the front door of the NYSE in five days.

From phone calls and letters received here, it is clear that the one thing subscribers are wondering about is whether this is a new bull market. I want to make the following observations:

(1) I've never seen a new bull market begin with margin debt at record levels (where it is now).

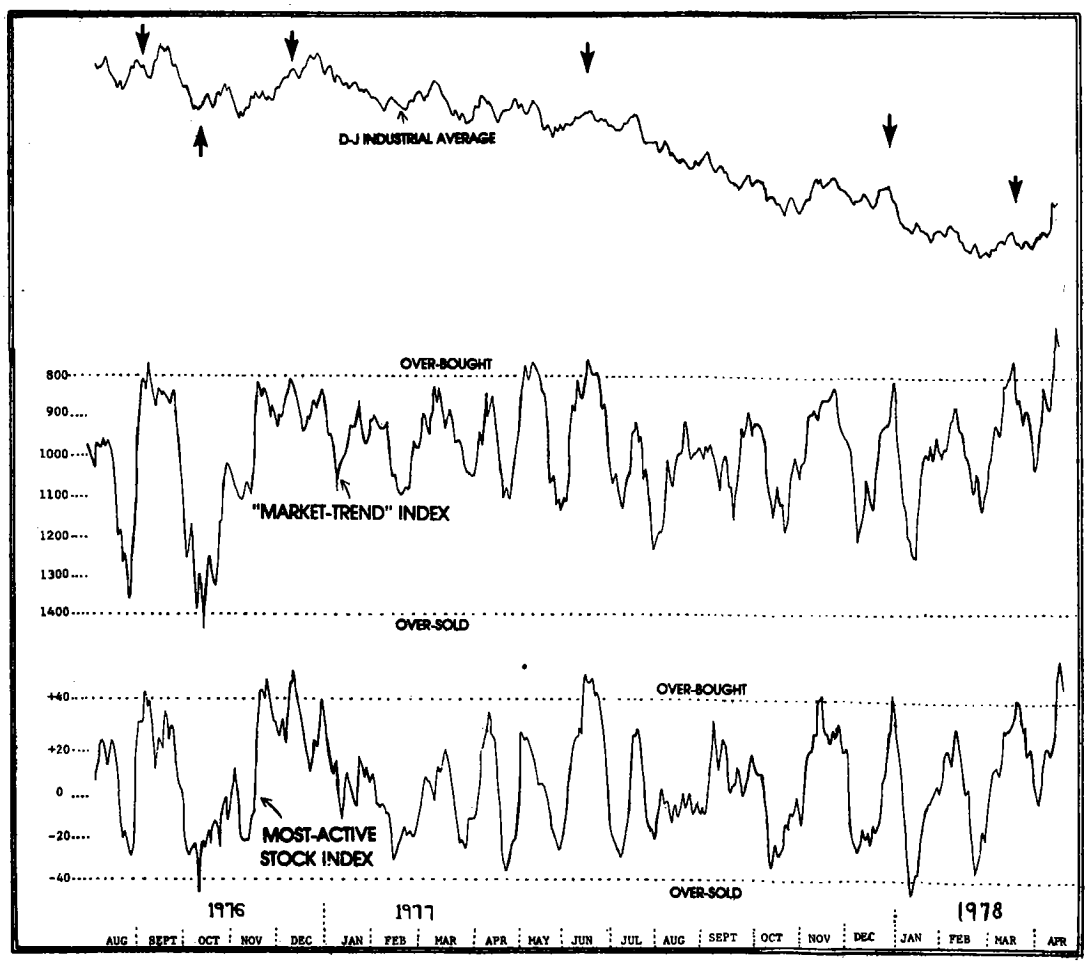
(2) I've never seen a bull market start with the D-J 20-Bond Average and the D-J Utility Average both in declining trends (which they are now).

(3) I've never seen a bull market begin from a base that was not over-sold (and at no time since late-1976 has this market been over-sold).

(4) I've never seen a bull market begin with the *Bank Credit Analyst's* "monetary thermometer" in the bearish mode (which it now is, at plus 9).

(5) I've never seen a bull market begin amid bubbling speculation in low-priced stocks and speculative issues (and they've been bubbling all through 1978).

(6) I've never seen a bull market start from a *Lowry's* Power Rating at over 40 as shown in Letter 726, page 3 (latest figure is 47).



Conclusion: After declining for 19 dreary months, with only a single rally of as much as 5%, the Dow was "tired" of sinking. By the same token, investors had been watching depressing news reports, a sliding dollar and an inept President for almost as long. Some steam had to be let out of the bear engine, and the big short interests (in the stock market and the dollar) had to be taught that it's a two-way street. The shorts are learning that lesson now. We're witnessing one of the most violent bear market corrections on record –all on history's highest volume.

But it's crucial to recognize this: even though corrections are happy and often exciting "breathers" (unless you're short of the market), they are not the real thing. Thus I feel that before 1978 has run out we'll again be seeing the various markets discounting the continuing problems–and breaking to new lows.

ADDITIONAL COMMENTS: I've often said that a rally in a bear market looks more impressive, more convincing than an advance in a bull market. Thus, the super-explosion of the past week caught the eyes of the world in a way that the 19-month decline in the Dow did not. There's nothing like volume and headlines to turn men's eyes toward Wall Street.

Ironically, the surprisingly small rise in the money supply reported on April 13 was widely accepted as a bullish factor. But I showed in Letter 726, page 1, that a declining rate of change in the money supply is a bearish influence on the market. People believe what they want to believe.

Margin debt on the NYSE increased to another historic record of $9.92 billion in March, up slightly from the $9.78 billion of February. But the margin debt would appear to be "plateauing", not a good sign.

The short interest on the NYSE increased by 6 million shares to a record 40 million shares over the latest period. This explains some of last week's upside gapping action. Since the specialists know what's on their books, they obviously saw the short build-up and thus much of the upside hysteria came from gap-openings as the specialists opened 'em up in many cases a point or more above the previous day's close.

STRAIN: My two indicators of over-bought and over-sold (page 2) have been telling an extraordinary story. Following the over-bought indications of March 17 (last down-arrow on the chart), the market backed off slightly, then pushed up again. This is almost standard procedure, and note that following each of the preceding over-boughts (down-arrows), the Dow declined slightly, then pushed to one more peak before turning down.

What makes the most recent action so interesting is that the monster-volume rally of mid-April has taken my two indicators to the highest joint levels of which I have any record. This means that the market isn't just over-bought, it's "ultra-bought." It's really a fascinating picture for those of us who follow the technical approach.

OLD FAIL-SAFE: Here's my chart of the three moving averages (MA's) of the Dow. The solid black line is a 50-week MA, a long-term or "primary trend" MA. The dotted line represents the 13-week MA, an intermediate-term MA. The third line is a 4-week MA, a short-term MA. Buying "alerts" (and selling alerts) are provided when the 4-week MA crosses above or below the 13-week MA. The really major buy (and sell) signals are given when the 13-week MA crosses above or below the 50-week MA. As older subscribers know, I give particular credence to any penetration of the 13-week MA through the 50-week MA which occurs in the direction of the primary trend of the market.

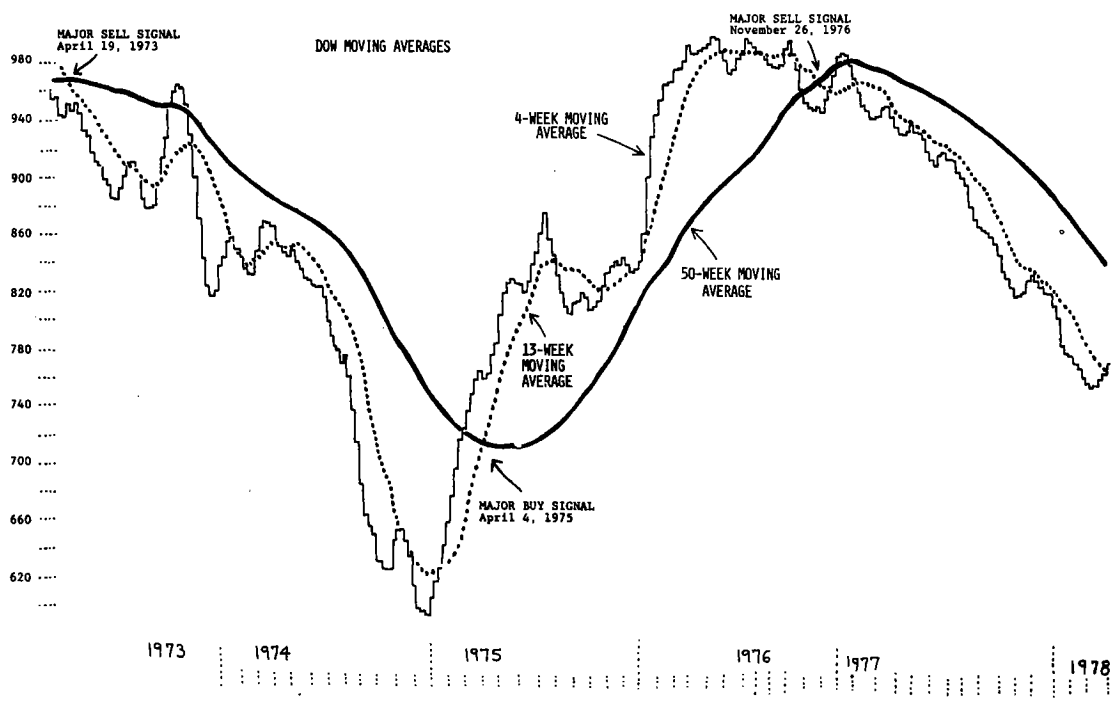
By construction, these signals have to come fairly early in a major and extended market move. Since true primary movements tend to be protracted both in duration and extent, they are usually signalled in ample time by the 13 and 50-week MA's.

To put it another way, the moving averages take both time and extent into consideration. Thus, for instance, a sudden wild upward spurt during a bear market (i.e., a big bear market rally) is probably not going to cross the 13-week MA above the 50-week MA. The reason is that it takes TIME for the two averages to cross, and bear market rallies do not usually last that long. But a big bull movement such as 1974-76 will be "captured" by the MA's. By the same token, a major market collapse such as 1973-74 will be signalled in time for us to avoid it, as you can see on the chart.

A well-known psychiatrist once told me, "It's easy to get married but hard to stay married." By the same token, I will tell subscribers that it's easy to buy stocks, but it's hard to make profits. For that reason, I don't lightly tell subscribers to jump in and buy stocks. I always, and I mean always, ask myself the following question: "Would I buy stocks here? Am I willing to do what I tell my subscribers to do?" If I'm not, I advise patience.

In the absence of the criteria that would make ME want to put my own money in this market, I turn almost instinctively to the study of the MA's (and of course last week's rally caused me to re-study this chart). As of this writing, the 13 and 50 week MA's are far apart, more than 70 points apart. Thus it would take many weeks before we could get a major bull signal under this study.

IF, "if" I thought this was a primary bull market I would be advising purchases on the basis of the buy alert as the 4-week MA (last week) pushed above the 13-week MA. But I don't think we are in a bull market, and therefore I will insist that the 13-week MA cross above the 50-week MA before suggesting even trading purchases.



MISSING THIRD LEG AND JULY, 1979: At times I like to move into the realm of theory and "what if" and "ah hah!" This is such a section, but I think it presents a most interesting concept and one that just may prove valuable.

But let's start from the beginning. In Letter 726 I ran a Fibonacci series that pointed to July, 1979 as a date of major import. Here's the way the series ran.

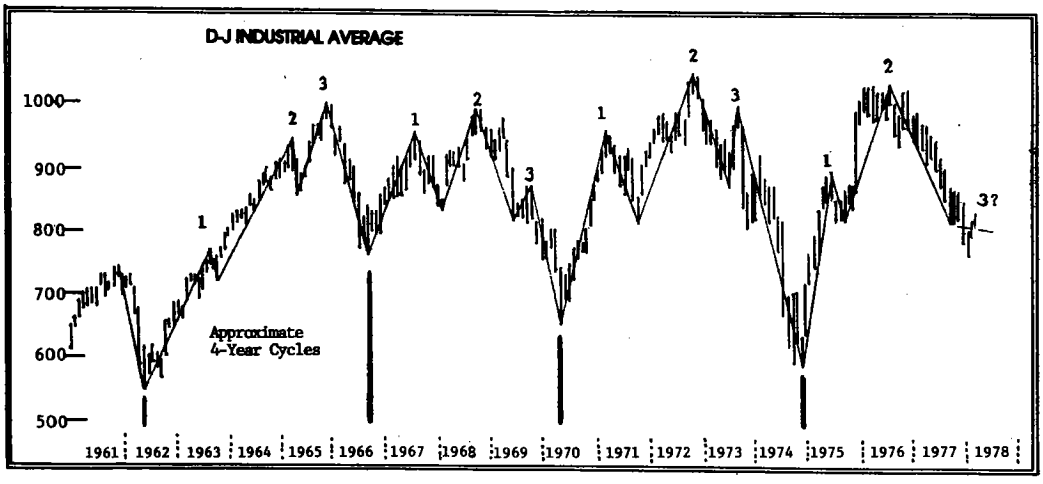
3 years from the 1976 top to 1979.
5 years from the 1974 bottom to 1979.
13 years from the 1966 top to 1979.
34 months from September 21, 1976 Dow top to July, 1979.
55 months from the December, 1974 Dow bottom to July, 1979.

But something bothered me. Where were the 8 and the 21 in this series? I could not come up with either number. Then last week I read the always interesting *Burns-Kirkpatrick Letter* (49 Riverside Ave., Westport, Conn. 06880). They drew my attention to a few factors that I had missed. First, they note (as I did in Letter 726) that the Dow seems to make an important low approximately every 4 years (give or take a few months). Furthermore, they note that each 4-year period seems to be subject to 3 intermediate moves. All this is shown on the accompanying chart (from Burns-Kilpatrick).

The dilemma has been to identify a third leg in the latest four-year period. Burns-Kirkpatrick may have solved the problem, in that they believe the third leg of the current cycle (1974-78) began in October, 1977, a period which saw the Dow at 800 and the Transports at 199.60. But the action of the widely-watched indices such as the Dow, the Transports, Utilities and the S&P and NYSE Composites has been so weak since October that it is almost impossible to identify the movement since October as "a third leg."

However, since October, 1977 the speculative segments of the market, the AMEX and the NASDAQ, have advanced broadly with their Averages going to new highs. They were joined by the Value-Line Composite. This bubbling over of the speculative stocks is a phenomenon which helps identify a third leg or phase in the latest four year cycle as shown on the chart.

I must confess that I did not identify the rise in secondary and speculative stocks since October, 1977 as a third leg or up-wave since 1974. But I do believe there is validity in Burns-Kilpatrick thesis. If the action from October to the present is indeed the "missing third leg," there are a number of interesting conclusions that may be drawn.



(1) The Dow put on a weaker performance during the period of October to April than during any of the third legs going back to 1961 (see chart). In fact, the Dow performance has been so substandard that it is seen on the chart as a sideways movement. When the current "third leg" expires, the weakness of the Dow should continue. This will probably give way to a major decline in the Dow (with most of the market following).

(2) If the action from October, 1977 to the present constitutes the missing third leg of the latest four-year cycle, then it has fascinating significance under the Fibonacci series. This is true because it is exactly 21 months from October, 1977 to July, 1979. Thus the "missing 21" in the series may have been discovered (the 8 is still missing).

(3) The stock market has not produced anything resembling an over-sold area in the past two years. The current advance may be the upward push that "exhausted" the market. If so, then I expect we could see at least an over-sold low of intermediate status (not an historic bottom) before the year 1978 is out. But the market, I believe, is shaping up for a classic bottom, a bottom with much more profit potential, in 1979.

(4) With the Dow as weak as it is, I would expect any further upside action in the Dow to continue at a sub-standard level. Thus, it would be surprising to me, despite any and all speculation in the rest of the market, to see the Dow as high as 850 on any further rallying action. The 850 level is where (see last Letter) the 13-month Dow MA broke below the 55-month MA.

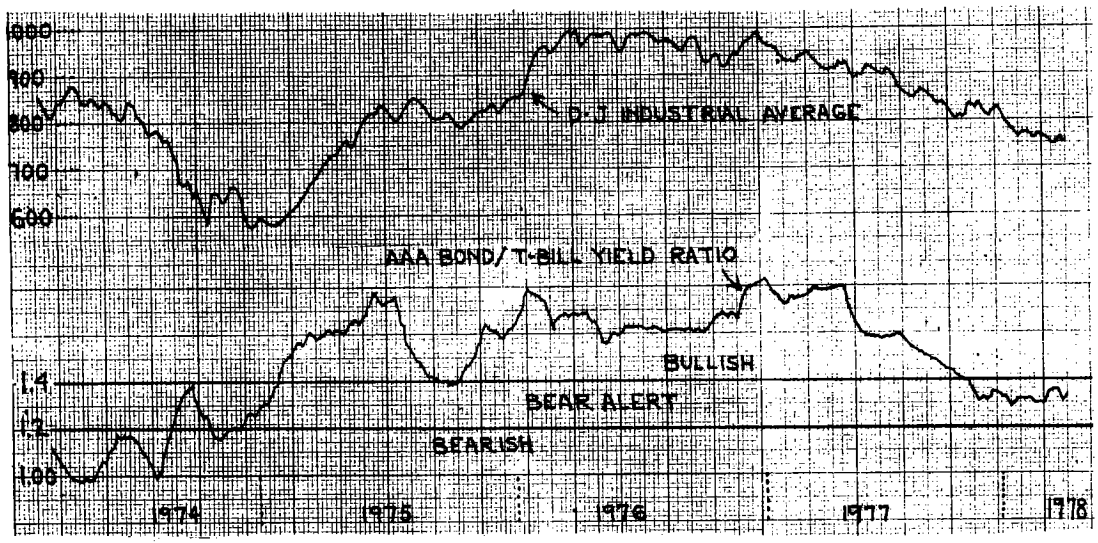
MONEY, MONEY: At any given time in history the monetary background is a critical influence on the stock market. But over recent years, with consistently high interest rates, with a weak dollar, with massive money flows, the monetary background has, if anything, become even more important.

For instance, the Government has to raise about $90 billion, and probably nearer $100 billion to finance the deficit plus keeping all the various and myriad Government agencies in green clover. Worse, the total Federal borrowing requirements continue to rise, and this means pressure, pressure and continuous pressure on interest rates.

Hamilton Boulton, founder of the *Bank Credit Analyst*, was a great pioneer in monetary analysis. One of the things he wrote was that the stock market can adjust to any level of interest rates, but it cannot adjust to changing levels of interest rates.

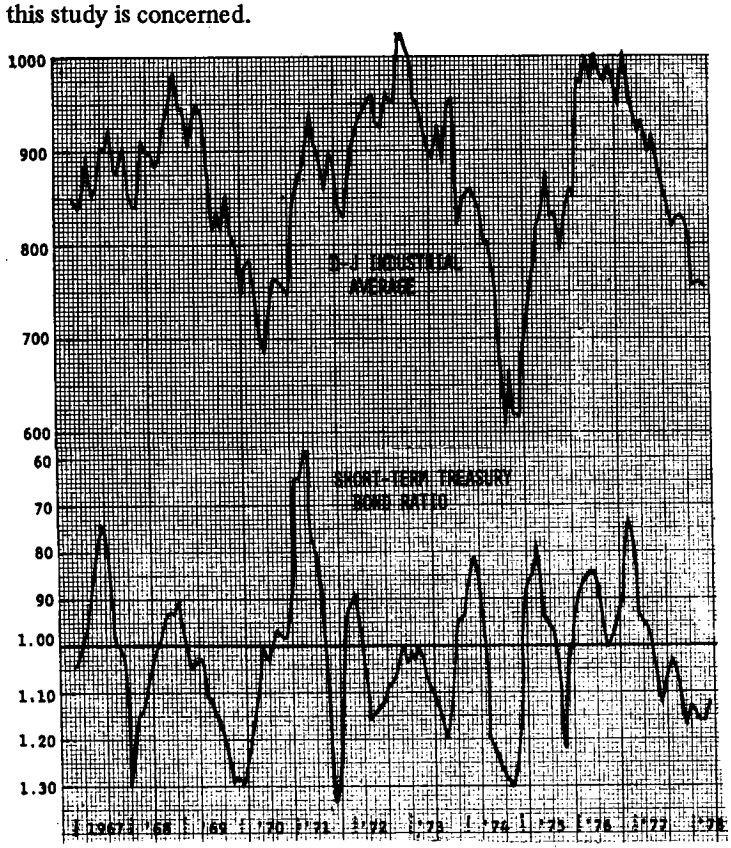
I keep a number of indices which serve to track changes in interest rates, but two of them are so simple and fundamental that they are worth reviewing at this time. The first is an index I keep on a weekly basis. I learned about this index from an English advisory, the *Stock Market Alert*. This index is simply the **yield** on AAA bonds divided by the yield on 91-day Treasury bills.

The theory is that long-term (bond) yields are normally higher than short-term yields. When there is little or no strain on the



monetary system, T-bill yields will be low in relation to bond yields. At such times, the yield ratio will be high. Conversely, when the short-term (T-bill) yields rise in relation to bond yields, the pressure is on the monetary system. In that case the ratio sinks to a low area.

The chart (top of page 5) tells the story. When the bill/bond ratio advances from a low level above 1.2, then above 1.4, we have a bullish signal. On the other hand, when the ratio drops below 1.4, then below 1.2, we have a bearish signal (as seen during 1974). Currently, with the T-bill rates in the 6.35% area and the AAA bond yields in the 8.5% area, the index is at 1.3. Because the index has dropped from a high level down below 1.4, we have a bear alert signal. Anything under 1.2 would be a clear bearish signal. For example, if the AAA bond yields hold at their present levels and T-bill yields rise above 7%, this would drive the ratio below 1.2 or into the bear zone. Thus, we have a good guide as to what to look for as far as this study is concerned.



Another study is based on the rate of change in intermediate term bond yields. This study was put out by *Becker Securities*. It is simple, easy to keep, and is an effective guide to monetary pressure. The index is based on short term Government yields as published in Standard & Poor's *The Outlook*. S&P's short term Government yields are an average of 2 to 4 year yields on Government notes (the notes are obviously maturities that are mid-way between bills and bonds).

This index is constructed by dividing the current short term yield by the yield six months ago. Thus it is a rate-of-change index which fluctuates above or below the 1.00 line. I have drawn the chart so that a trend of rising interest rates (compared to rates six months ago) has the effect of sending the ratio to lower levels. Conversely, a trend of declining current rates sends the ratio to higher levels. The crossing of 1.00 from above or below provides the signals. These buy and sell signals are shown (courtesy of Becker) as follows:

Buy Signals In	DJIA Market Avg.	to	Peak
1966 - Dec.	802	to	909
1968 - Aug.	822	to	985
1970 - Jun.	701	to	950
1971 - Nov.	820	to	950
1974 - Jan.	851	to	891
1974 - Nov.	641	to	879
1976 - Jan.	916	to	1,014

Sell Signals In	DJIA Market Avg.	to	Low
1967 - Jul.	884	to	825
1968 - Dec.	964	to	631
1971 - Jun.	898	to	798
1972 - Mar.	939	to	788
1974 - Apr.	848	to	584
1975 - Jul.	850	to	784
1977 - May	920	to	742

I keep this index on a first of the month basis. For instance, the April 1, 1978 yield was 7.41. Comparing this with the yield 6 months ago (October's 6.63) gives us a ratio of 1.11, which is in bearish territory. The bearish signal(as you can see on the tabulations) came in May, 1977, when the ratio plunged below 1.00. That bearish signal is still in effect.

BULL SIGNALS: With the recent action, the usual confusion and misconceptions arise as to what a primary bull signal would look like. Incredibly, few analysts know. But first, let's get one basic concept in mind. Under Dow Theory, once the two Averages (Industrials and Transports) go to new highs (or lows) together, the significance of all previous points is erased.

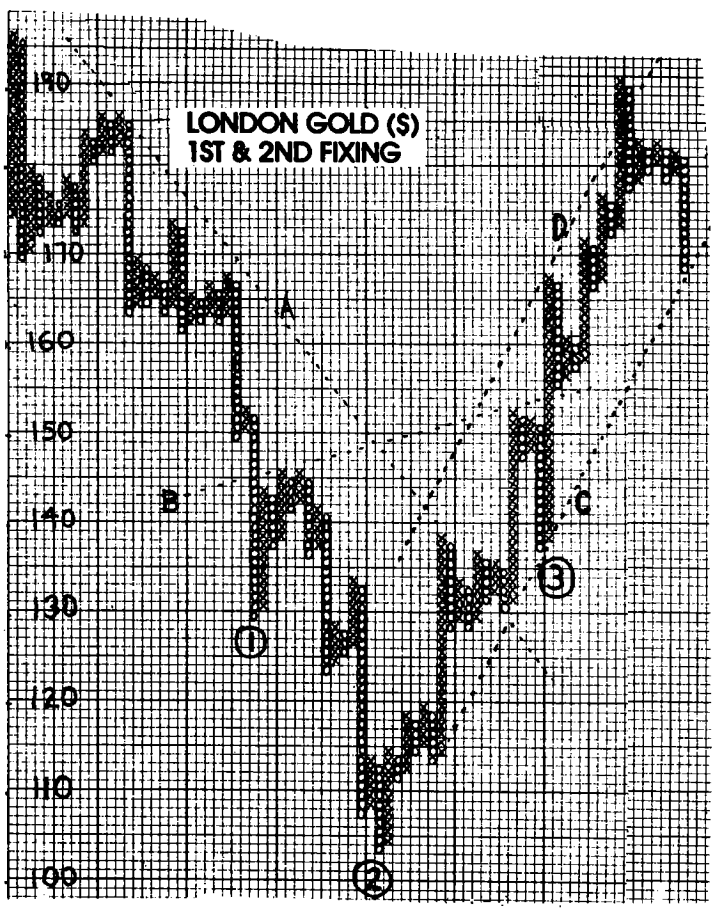
Referring to the current situation, Industrials broke to a new bear market low of 742.12 on February 28. Transports confirmed by sinking to a new bear market low of 199.31 (see p.1 chart) on March 9. Thus, the significance of all preceding points was obliterated. The Averages had started "a new ball game."

Next, the two Averages embarked on a five-week rally to the April highs. From whatever highs are established, there will be a sell-off. If the sell-off fully corrects the advance in time and extent (it should correct at least a third or more of the advance

and last for two weeks or longer), the situation becomes interesting. For if the next advance then takes **both** Averages above their preceding highs, a bull market (at least mechanically) is signalled.

GOLD: William Simon's new book, "A Time for Truth" has just been published. Beg, borrow or steal it–but read it! The whole, dismal story is there. So are the fundamentals for gold. This excerpt is from page 98 . . . *"By the time Lyndon Johnson's Great Society was in full swing in fiscal year 1966, federal outlays had reached $135 billion. Eight years later, under Nixon, expenditures doubled to $269 billion. Even when the Vietnam War was over, during the next two fiscal years 1974-76, federal spending had increased again by 35% to $366 billion. Another large increase was to occur in fiscal 1977 with President Ford proposing a budget of $396 billion and the concurrent resolution of Congress calling for an outlay of $413 billion."* And I'll add that Carter's new "lean" budget is $500 billion.

The US debt and spending keeps climbing mindlessly, wildly, and the politicians still live by the old adage, "Nobody ever won an election by promising to spend less." But the US Government has its own answer to the debt problem–deceit, subterfuge, manipulation, propaganda. This month's manipulation is the long-awaited promise to "sell gold!" Yes, the US is going to auction off $300 million in gold over the next 6 months. With $300 **billion** in dollars floating around overseas, this token amount of gold equals about one-tenth of 1% of the available overseas dollars! Therefore, I doubt that the US's long-cherished hope of "breaking the gold market" will be accomplished. No, the only thing they will accomplish is to deplete the nation's precious metal reserve assets. If it wasn't so tragic, it would just be a bad joke.



Meanwhile, the price of gold, already in a corrective phase, sank to the 168 level last week-then quickly recovered to the 170 level (see point & figure chart). I continue to feel that gold is forming a "right shoulder" for the massive "head-and shoulders" base shown on the chart. The right shoulder consolidation is going to take time, but again patience is the watchword. So far, the correction has held within the rising channel (C-D on chart), but even if the channel does break there is heavy support in the 160's for gold.

As far as the recent rally in the dollar is concerned, I have repeatedly pointed to this possibility. The fact is that a huge short interest has built up against the dollar. These shorts have been having the ride of the century. But all good things come to and end–or at least they are temporarily interrupted. Just as the stock market shorts have had their week of terror, the dollar shorts have had theirs. This has just not been a good month for the late-arrival short sellers. And for us, it's a good time to remember the old adage, "The market always does what it's supposed to–but never when." Here's my own variation: "The market never seems logical over the short-term, but over the long-term it is always logical."

At any rate, with the US continuing to manufacture deficits and fiat money, it's logical to believe that the bull market in gold will continue. But gold won't "pop" just to please every new buyer. It will go when it wants to.

One concept I want to get over to subscribers is the awful power of compounding–in this case *the compounding debt.* By the end of 1978 the US Federal debt will be near $800 billion, and this amount will be carried at high interest rates. The Federal debt is now rising $7 billion a month. Those of you who have calculators might fool around with this concept, project the figures a few years into the future. Then you will understand why we are on the inflation path. We're on it because we're compounding the biggest debt in history at progressively higher interest rates. The result–inflate or die. There's no way the US can stand still under this situation. And the gold floor (support levels) keeps moving higher.

LATE NOTES: The rally from the February 28 low has taken the Dow up 9.7% to touch its 200-day moving average (which now stands at 814). The Dow has not corrected back to its 200-day MA since December, 1976, so this kind of action was long overdue. Meanwhile, bonds are weakening again with the D-J 20 Bond Average at its low for the year at 89.20. But the feature of the past few weeks has been the weakness in Municipal Bonds. Those who heeded long-ago advice to move out of bonds and into T-bills are now well ahead of the game.

As an aside, the Dow Jones Municipal Bond Average now yields 6.45, up from 5.94% exactly one year ago. This is a rise of 8.6% in yields for the average Muni. It also means that the average Muni bond is down almost 8% from a year ago. This is turn means that although the holders of Muni's have been getting Federal tax free income, they are in many cases now showing capital losses. The huge multi-billion dollar Muni market is highly illiquid, and I think it is possibly the weakest spot in the whole stock-bond picture. Rising Muni yields are heavy competition for equity dividends.

NEXT MAILING: May 5th